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UNCLAS SECTION 01 OF 02 BELGRADE 000401

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OC FOR 4232/ITA/MAC/EUR/OEERIS/SSAVICH

E.O. 12958: N/A

TAGS: EFIN ECON ECPS ENRG EINV KIPR SR MW

SUBJECT: FINANCE MINISTER ON INVESTMENT ISSUES

¶1. (SBU) SUMMARY: Ambassador Polt met with Finance Minister Mladjan Dinkic on March 7 to raise several issues involving U.S. investors and economic policy. Dinkic pledged to be helpful in resolving issues related to U.S. Steel and the gas shortages that are affecting production at the company. He agreed to meet with Philip Morris to discuss regulatory issues that have eroded the company's prospects in Serbia, but noted that the company had been consulted on many of these changes. The finance minister said he was an advocate of strengthened IPR protection and would consider instructing tax inspectors to look for pirated software. When Ambassador Polt raised GOS intentions with regard to state-owned Dunav Insurance, Dinkic revealed that the GOS planned to permit the EBRD to take a 25-30 percent stake through a capital increase, before an IPO or other form of privatization over the medium term. end summary.

¶2. (SBU) Ambassador Polt met with Finance Minister Dinkic on March 7 at the Ministry of Finance. The Ambassador was accompanied by econ chief, while Dinkic was joined by Sonja Mihajlovic-Milanovic, energy adviser to Deputy Prime Minister Labus, and three staffers. Embassy had requested the appointment to raise several issues, including problems encountered by U.S. Steel and Philip Morris. (Note: Ambassador actually met with Dinkic twice; the second meeting, reported septel, including Mara Harty, assistant secretary for consular affairs.)

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¶3. (SBU) Ambassador began the discussion of investment issues by commenting on recent press reports indicating that the GOS team had worked out a deal with Austrian investors that would protect their interest in cellular operator Mobtel. Dinkic confirmed that the Austrians should realize at least 18 percent of an estimated USD 700 million in proceeds from a tender for Mobtel assets, its customer network and the license. However, Mobtel itself, as a legal entity, would be liquidated, Dinkic said. This guaranteed the Austrians a minimum of USD 126 million, to cover the USD 100 million they claim to have paid Bogoljub Karic and a USD 30 million Ericsson claim for which they will take responsibility. If the sale price goes higher, the Austrians will gain, Dinkic said. All legal claims would be dropped, and if Karic is not satisfied, he can take court action against the Austrians, the finance minister added. To ensure a good price in the tender, the GOS will guarantee the buyer that it will not sell a third cellular license during the next 2 years at a price lower than the price the Mobtel license brings at tender, an estimated USD 300 million.

¶4. (SBU) Two U.S. investors, U.S. Steel and Philip Morris, recently had sought Embassy assistance, Ambassador Polt said. Interruptions in gas supplies caused by the dispute between Russia and Ukraine, as well as cold weather, had disrupted U.S. Steel's production in January and February and cost the company a considerable amount of money. However, last week, on March 1-2, Srbijagas again had reduced gas to U.S. Steel. The Embassy had learned that this apparently occurred because fertilizer producer Azotera Pancevo had started up its highly energy-intensive production process. In this case, the disruption was not a development that affected all players, but rather, it was a non-market based decision by Srbijagas. U.S. Steel now was deeply concerned about whether Srbijagas could guarantee a reliable supply of energy, the Ambassador said.

¶5. (SBU) Dinkic said it would be helpful if U.S. Steel signed a long term contract with Srbijagas and thereby provided a clearer projection of its energy needs. U.S. Steel is Serbia's largest exporter, and it was important to meet its needs, the minister added. Long term, the answer is underground storage. Dinkic said he would talk with Srbijagas Executive Director Tomic about a three-year contract for U.S. Steel. The Ambassador replied that he understood that U.S. Steel was prepared to sign such a contract, but it must provide for peak usage, a fact of life for this sort of industrial operation. (Note: U.S. Steel has said that it had in the past requested a long-term supply contract, but the Srbijagas had been unwilling.)

16. (SBU) The Ambassador reiterated our concern over the March reduction, which occurred because Srbijagas elected to provide gas to the fertilizer company and cut back others. Dinkic said he would check with Tomic on this point; in his opinion, the finance minister said, any cutbacks should be applied proportionally to all and not fall more heavily on one customer. But he emphasized the GOS is committed to carrying out the gas storage project quickly, with the tender to begin within 50 days. Ambassador Polt stressed that completion by next winter is critical. Sonja Mihajlovic-Milanovic added that Serbia must complete phase one of the project on time. Dinkic said that the GOS is aware that better infrastructure is needed to support economic growth. The GOS had decided how to proceed, and the upcoming tender would select the best strategic partner for this project.

17. (SBU) Philip Morris also had approached the Embassy recently, Ambassador Polt said. Country director Eugenio Sidoli presented a comprehensive analysis of the company's experience since acquisition of the cigarette factory in Nis, detailing how events, including some regulatory changes, had progressively undermined profitability. Philip Morris was seeking an accommodation with the GOS to turn this trend around. Dinkic expressed surprise, explaining that he was aware of only two issues -- a small per pack surcharge for health purposes to which the tobacco companies had agreed, and a decision by Montenegro to add its own excise tax to cigarettes, which was beyond Serbia's control. The latter issue could be resolved by the outcome of Montenegro's independence referendum, the minister added. Dinkic agreed to meet with Sidoli to review Philip Morris's concerns.

18. (SBU) Ambassador Polt then raised the need for stronger protection of intellectual property rights (IPR). The Embassy had been successful so far in convincing Washington of Serbia and Montenegro's (SaM) commitment to improving IPR protection, thereby helping the country to avoid the censure of the Special 301 watch list. But the review process has begun again, with U.S. industry seeking to put SaM on the watch list, the Ambassador explained. GOS action on further steps to strengthen IPR protection would help keep SaM off the list, and one of these steps involved the tax police, which operate under the Ministry of Finance. Tax inspectors are not verifying whether software used by firms is legitimate, the Ambassador said. U.S. software companies have asked the Tax Administration to order inspectors to check on this and report violations to the appropriate authorities. The Embassy is aware of the considerable progress already made on IPR, Ambassador Polt said, but we need GOS focus on a few specific areas to be able to assure Washington that the GOS was doing all it could to improve IPR protection.

19. (SBU) Dinkic expressed surprise, saying that he had asked all ministries to work on IPR protection but was unaware of a specific area in which tax police were not being helpful. The Minister recommended that Embassy representatives meet with Deputy Finance Minister Vesna Arsic, along with the Tax Administration officials, to review the matter. Sometimes tax authorities resist new approaches, Dinkic said, but it might be possible to work this out without a change in the law. Econ chief added that those who buy pirated software are paying far less than they would for authorized products, and this represents a loss of VAT revenue to the Ministry.

10. (SBU) The discussion turned to economic policy as Ambassador Polt queried Dinkic on GOS plans for Dunav Insurance, a state-owned company and Serbia's largest insurer. Privatization would be the best step, especially with Dunav's exposure to foreign exchange risk through its program of insuring retail bank loans, the Ambassador said, but there had been press reports that the GOS opposed privatization. Dinkic replied that the GOS would follow the same approach with Dunav as it has with Komercialna Banka, bringing in the EBRD as a major investor to help in the restructuring of Dunav. A smaller state-owned insurer, DDOR, could be privatized right away, but Dunav needed work, including more unbundling of non-core operations. This also could enhance the value of the company, Dinkic said. Privatization, perhaps through an IPO, would come later. But he agreed with the Ambassador that Dunav needs work.

11. Comment. Dinkic clearly was trying to be helpful on a variety of issues. Embassy will follow up with Finance Ministry and with other GOS interlocutors regarding specific steps on IPR protection. We are seeking GOS agreement to an IPR action plan that includes measures aimed at various shortcomings that affect the position of U.S. companies in the SaM market. End Comment.

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